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SUBJECT: GROWING TRADE BETWEEN CHILE AND CHINA

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¶1. (U) Summary. Chile's economic ties with China are increasing. In 2005, China became Chile's number two trading partner, consuming over 12 percent of Chile's exports, and the two countries signed a partial trade agreement. Chinese companies are increasing their investment in Chile, with the focus likely to be on Chile as a source of copper. Chinese goods are beginning to appear on the Chilean market, as the market share of Chinese vehicles imported to Chile jumped to over 10 percent of the imported vehicle market in 2005. End Summary.

Trade Paves the Way

¶2. (SBU) Ten years ago, China bought just 1.4 percent of Chile's exports. Between 1994 and 2003, Chile's exports to China grew by 1,299 percent. In 2005, China became Chile's number two trading partner, consuming nearly 12.5 percent of Chile's total exports. Despite the public perception that China is buying only Chilean copper, copper comprised just 20 percent of what China bought from Chile in 2005. The other main Chilean exports to China were fish and paper products. In November 2005, Chile and China signed a partial trade agreement that is likely to boost bilateral trade further. Chile is the first Latin American country to sign a trade agreement with China. Chilean trade officials are very proud of this and openly express the conviction that Chile's future is fundamentally tied to trade with Asia, with China seen as the linchpin in Asia.

Huge Joint Venture in Copper

¶3. (SBU) In 2005, while copper comprised just under 20 percent of Chile's trade with China, that percentage did represent a 34 percent increase in Chilean copper exports to China over 2004. China's interest in Chile as a source of copper is evident in the USD 2 billion joint venture signed in February 2006 between MinMetals Corporation and Chile's state-owned copper producer, Codelco. Codelco currently accounts for 40 percent of Chile's copper production but has ambitious plans for the future. Over the next fifteen years, it hopes to almost double annual production and needs to

invest an estimated USD 1.7 billion to accomplish that goal. The joint venture with China provides Codelco a guaranteed market and new financing options.

¶4. (SBU) On February 22, the Executive Director of Chile's state mining company Codelco, Juan Villarzu, and the Undersecretary of Mining , Mario Cabezas, signed the final papers to formalize the joint venture with China's MinMetals Corporation. As the first part of the USD 2 billion sales, finance and investment agreement, Codelco and MinMetals will set up a joint venture with an initial Chinese investment of USD 550 million. In exchange for this Chinese investment, Codelco will guarantee MinMetals a total of 836,250 metric tons of copper over the next 15 years. MinMetals can also exercise an option in 2009 to purchase 25-29 percent of the shares in Codelco's newly developed Gaby copper mine.

¶5. (SBU) To finalize the deal, Chilean and Chinese officials resolved two key issues:

- The PRC Government authorized the China Development Bank (CDB) to play a role in the joint venture. CDB will act as the guarantor agent and loan provider in a CDB-designed financing structure. CDB will provide USD 330 million of the total USD 550 million for the first part of the joint venture.

- There had been some debate about the valuation of the joint venture, given dramatic increases in worldwide copper prices. Villarzu stated that for the purposes of the joint venture copper was valued at USD 1.20 per pound, which reflected the nominal price estimate from May 2005 - February 2006. Viewed over the 15-year period of the deal, both sides agreed that this price was above the long-term guaranteed market price for copper. However, China appears to value access to a long-term steady supply of copper over benefiting from fluctuations in the market price.

Smaller Ventures -- A Mall and More Chinese Cars

¶6. (SBU) February 2006 also saw the opening of Chile's First "Chinese Mall" in downtown Santiago. The "Centro Commercial China" comprises about 80 shops selling textiles, jewelry, clothing and shoes. According to the Chinese merchants manning the shops, they are all from the Chinese city of Wen Zhou, in Zhejiang province south of Shanghai. The shop owners told econoff the commercial center is reserved only for Chinese products produced in Wen Zhou and is being facilitated by a Chinese businessman, Ji Rubin, who has been working in Chile for the past nine years. Many of the merchants complained about the Chilean tax requirements. They were under the impression that once the basic licensing fees had been paid to the Chilean government there would no need for further formal interaction with the government.

¶7. (U) The Chilean press has described the mall's opening as the most visible impact of the November 2005 Chile-China trade agreement. The catch to that description is that the trade agreement has not been ratified by the Chilean Congress and thus is not yet in effect. Total investment in the mall is estimated at USD 20 million. While not a significant amount, the Chinese and Chileans working at the "Chinese Mall" clearly feel they have taken the first small step toward making Chile the platform for China's business presence in South America.

¶8. (U) While easily overlooked in the mass of imported Japanese cars on Chile's roads, vehicle imports from China jumped in 2005 by over 70 percent. For 2005, Chilean vehicle imports from China totaled USD 187 million in total value. Motorcycle imports from China doubled, industrial vehicles imports rose 75 percent and Chile began importing Chinese-made buses. The value of Chilean vehicle imports in 2005 totaled USD 1.71 billion, meaning Chinese vehicle imports to Chile comprised just under 11 percent of that total.

Comment

¶9. (SBU) Comment. While a large part of China's interest in Chile is obviously copper, China likely also sees Chile for what it is -- a politically stable country with an open economy. As such, Chile can serve as a platform for trade with the rest of Latin America. From Chile's perspective, with only 20 percent of its annual copper production going to China, it does not feel particularly beholden to China. Chile sees China as the key to Asia, and it would like to use the new trade agreement to sell more to its biggest market in Asia than just copper. Given the rise in Chinese goods from textiles to cars now entering Chile, it's also clear China has diversification on its mind and intends to do more in Chile than just buy copper.
KELLY